IFRS 17
Impacts to the Reinsurance Industry

Casualty Actuaries in Reinsurance (CARe)

Brooklyn, New York

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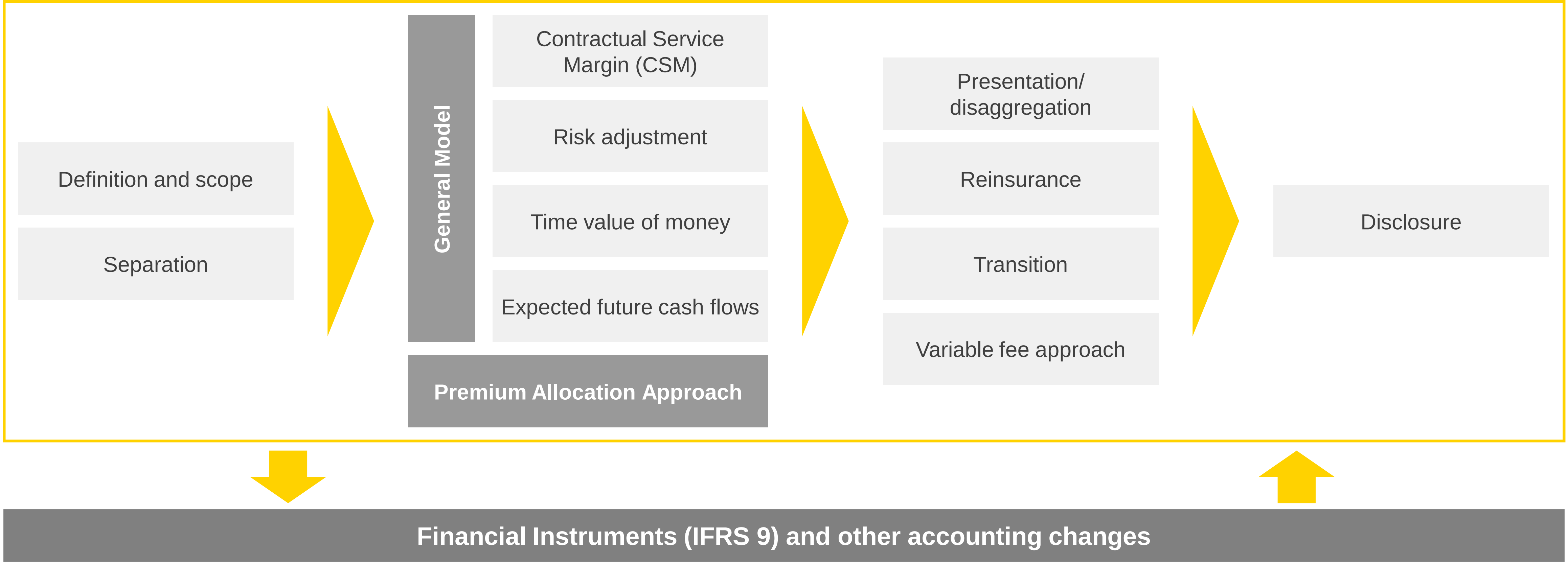
Building a better working world

Agenda

IFRS 17 – Overview of the new standard

- The new standard provide a comprehensive framework to recognize, measure and report insurance and reinsurance contracts



IFRS 17 – Overview of measurement model

	Key features	Example products
General Model (GM)	▶ Default model in IFRS 17 known as the general model ▶ Probability weighted discounted cash flows ▶ Risk adjustment ▶ Market-based valuation of options and guarantees ▶ Contractual service margin (CSM): to spread recognition of profit and impact of changes	▶ Annuities ▶ Protection ▶ Long-duration non-life business ▶ Acquired business including LPTs
Variable fee approach (VFA)	▶ Based on the building block approach, but with additional features for direct participating contracts ▶ Market volatility passes through CSM vs Statement of Comprehensive Income (P&L/OCI) for building block approach	▶ With-profit business ▶ Unit-linked business
Premium allocation approach (PAA)	▶ Optional approach for short duration contracts (liability for remaining coverage) ▶ GM approach used to determine remaining exposure (liability for incurred claims)	▶ Short-duration contract (mostly non-life insurance)

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Scope

Application confirmed ✓

Insurance contracts

Reinsurance contracts held by insurance companies (amended guidance)

Investment contracts with a discretionary participation feature issued by insurance companies

Excluded from application ✘

Financial guarantee contracts, unless the issuer has previously classified them as insurance contracts.
Warranties or residual value guarantees provided by a manufacturer, dealer or retailer.
Insurance contracts in which entity is policyholder (except reinsurance contracts held).
Contingent consideration in a business combination.

Application optional ?

Expansion of the guidance for certain fixed-fee service contracts
(Choice between application of IFRS 17 or IFRS 15 if certain conditions are met)

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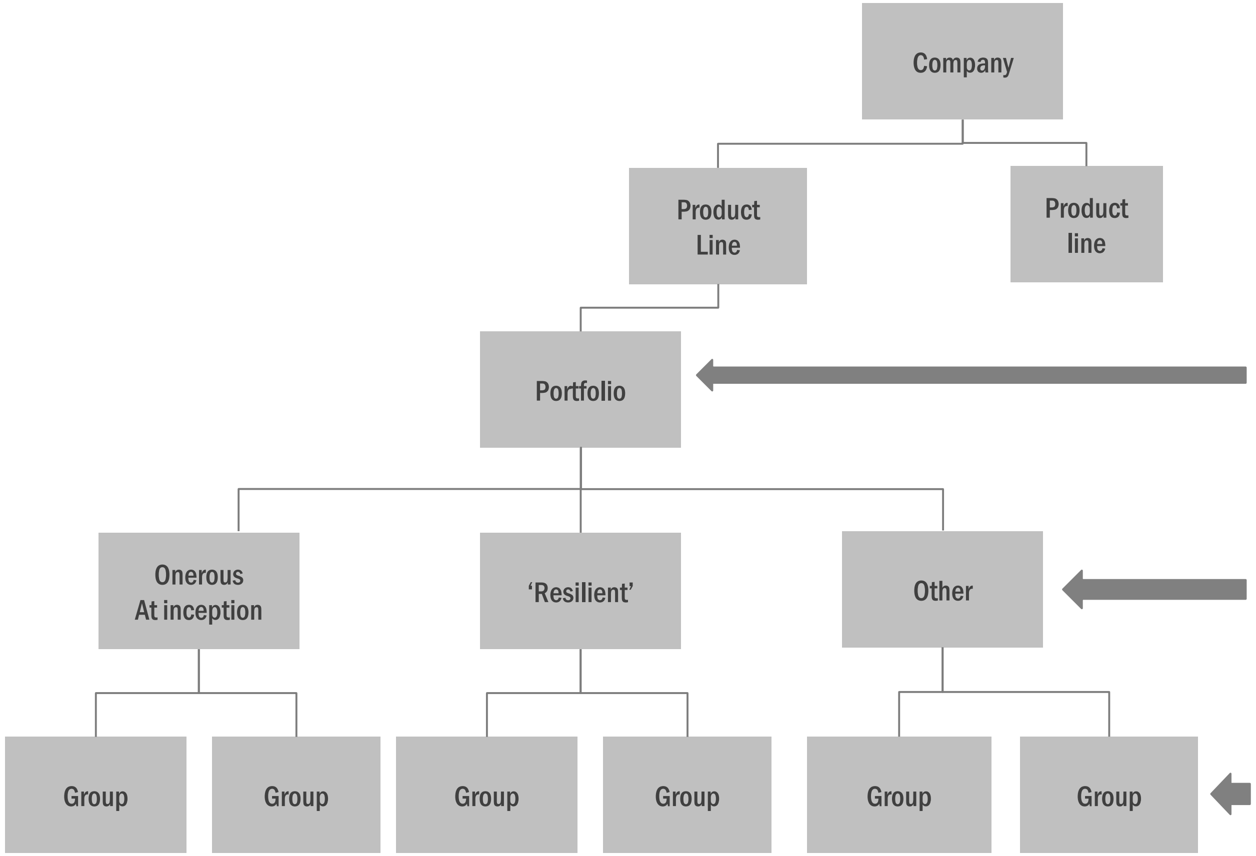
Level of aggregation
A fundamental ingredient for recognition and measurement

Assessment is done at contract inception – no subsequent re-assessment



Assessment could be top-down for 'sets' of contracts based in reasonable and supportable information, otherwise based on individual contracts.

Contracts subject to similar risks and managed together. Contracts in different product lines will be in different portfolios, but a product line could have multiple portfolios.

Onerous contracts at inception to be identified separately. Additional disaggregation based on whether there is a significant possibility of becoming onerous subsequently. (No such significant possibility – 'resilient'). Facts and circumstances test under PAA.

Disaggregation based on contracts written no more than a year apart ('group').
Basis for subsequent tracking and releasing of CSM
-> 'Group of contracts'

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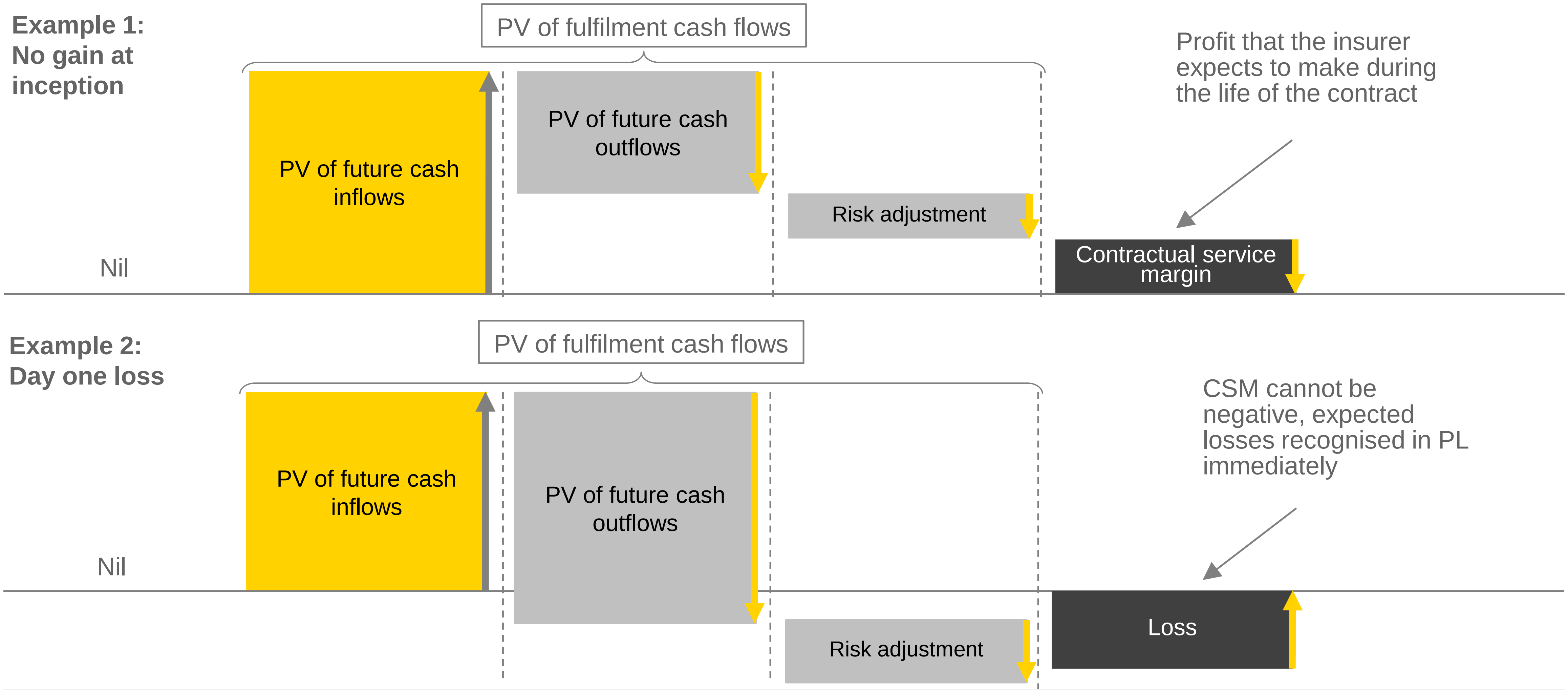
GM – Measurement on initial recognition



GM – Measurement on initial recognition – Cash flows and contract boundary

Contractual service margin

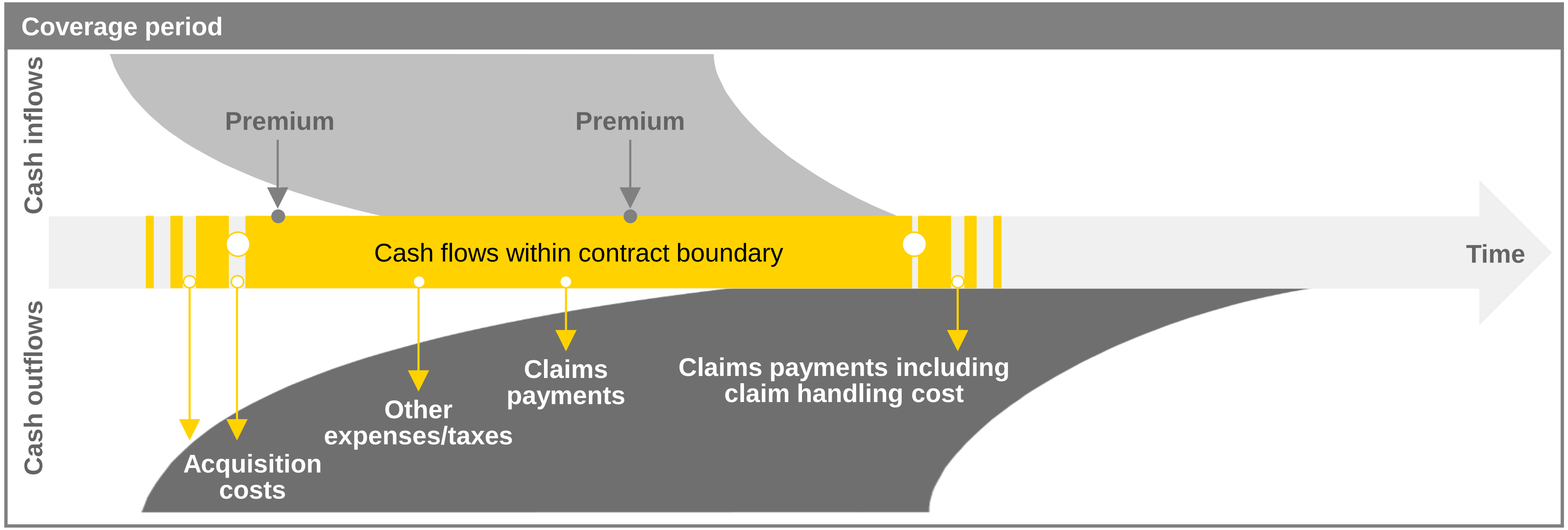
Risk adjustment

Time value of money

Future cash flows

The estimates of CFs used to determine the fulfilment CFs shall include all cash inflows and outflows that relate directly to the fulfilment of the portfolio of contracts:

- Current and explicit (separate from discount rate and risk adjustment)
- Incorporate all available information in an unbiased manner (including trends)
- Include all CFs within contract boundary
- Perspective of the entity (provided that market variables are consistent with observable prices)



GM – Measurement on initial recognition – Time value of money

Contractual service margin
Risk adjustment
Time value of money
Future cash flows

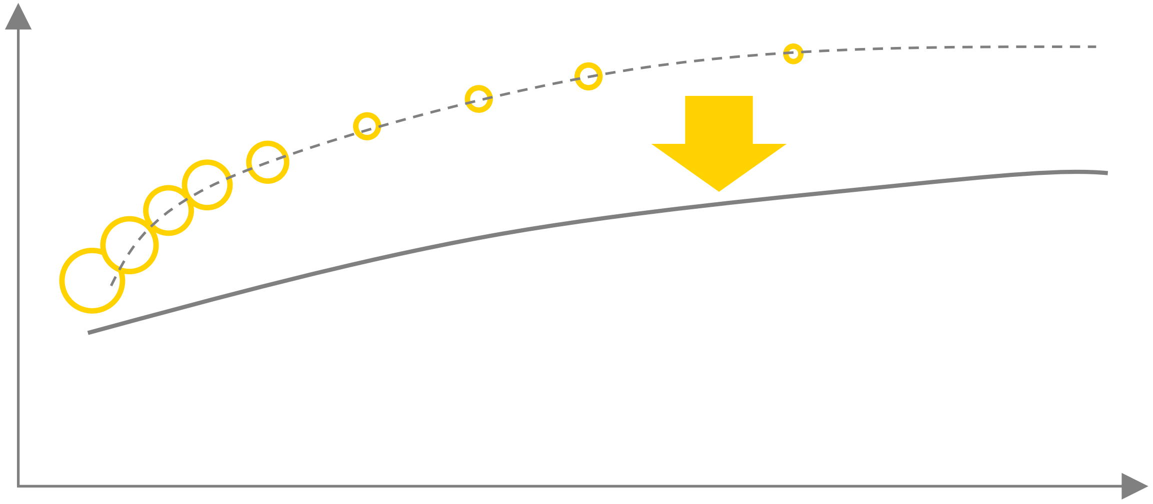
- Adjust the estimates of future cash flows for the time value of money using discount rates that:
  - Reflects characteristics of fulfilment cash flows
  - Consistent with observable market prices for instruments with cash flows that have consistent characteristics with insurance contract, e.g., with respect to timing, currency and liquidity
  - Adjust observed market prices to reflect the characteristics of the liability/the factors that are relevant for the contracts, e.g., exclude irrelevant risks, estimate the rate beyond the period of observable data
  - Consistent with other estimates used to measure the insurance contract (e.g., inflation, discount rate for participating contracts)
- No particular method prescribed to determine discount rates:
  - Top-down approach or bottom-up approach
- When applying PAA: no need to discount cash flows which are expected to be paid or received in one year or less

GM – Measurement on initial recognition – Time value of money-estimating discount rates

Top-down approach
Current market rates of returns:
either of own asset portfolio or a reference portfolio

Adjust for **risks that are not relevant to the insurance contract,** e.g., default risk, market risk

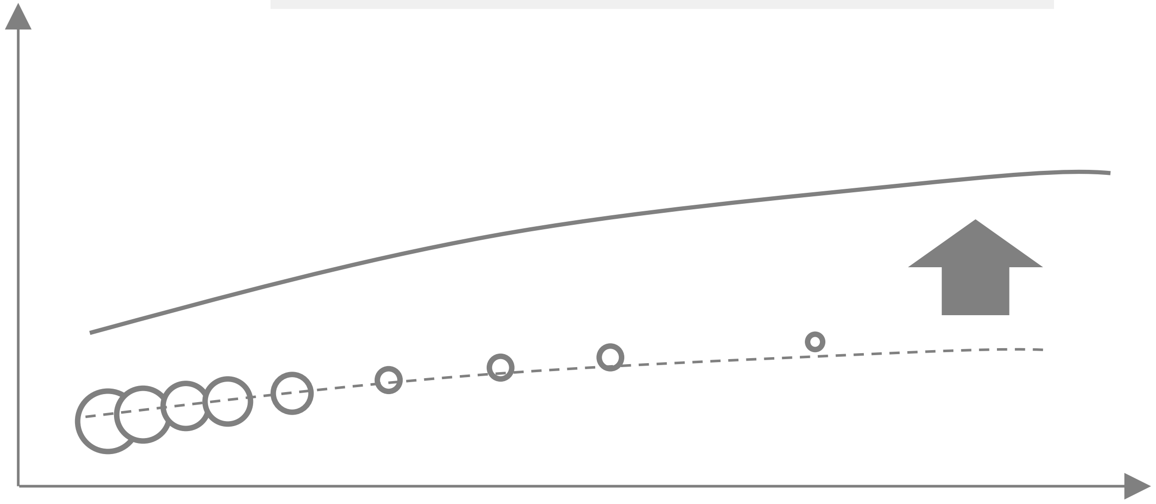
Adjust for **duration differences** if necessary
(No need to adjust for the difference due to liquidity)



Adjust for **other characteristics** of the insurance contracts if necessary

Illiquidity premium: Adjust for liquidity characteristics of the insurance contracts

Bottom-up approach
Risk-free yield curve with similar characteristics (e.g., duration, currency)



GM – Measurement on initial recognition – Risk adjustment

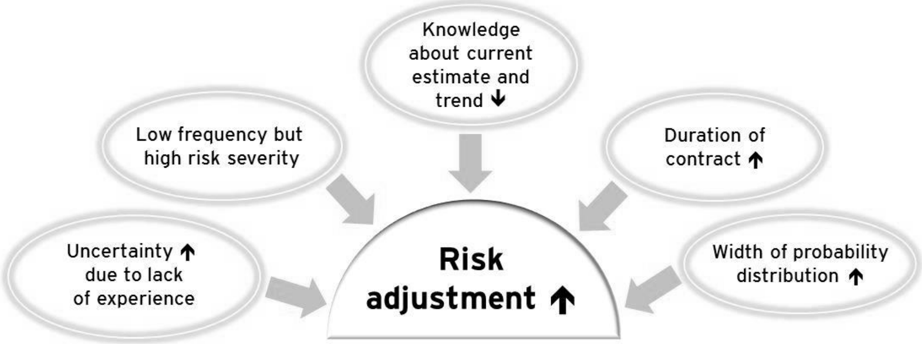
Contractual service margin

Risk adjustment

Time value of money

Future cash flows

- Compensation that an entity requires for bearing the uncertainty about the amount and timing of the cash flows that arise as the entity fulfils the insurance contract
- RA shall be included in the measurement in an explicit way (i.e., uncertainty should not be included in the future cash flows)
- Reflects both favourable and unfavourable outcomes in a way that reflects the entity’s degree of risk aversion
- Conveys the degree of diversification benefit that is considered when determining the compensation for bearing uncertainty
- No prescribed technique so different companies may use different techniques
- Disclosure on the confidence-level is required if the entity uses a technique other than the confidence level technique



EY

GM – Measurement on initial recognition – Contractual service margin

Contractual service margin
Risk adjustment
Time value of money
Future cash flows

- At initial recognition, the CSM is defined as the net difference between the fulfilment cash inflows and outflows, floored by zero (i.e., cannot be negative)
- Purpose of recognising a positive initial CSM: Objective is to report expected profitability from the contract over time (thus eliminating any day-one gain)
- If CSM is floored by zero at inception, the insurance contract is onerous. Losses should be recognised in P&L immediately
- Interest applied to CSM is calculated with initial discount rates (locked-in)
- Objective for allocation to recognise the contractual service margin for an individual contract, or groups of homogeneous contracts, in profit and loss over the coverage period of the contract in a way that best reflects the service to be provided

Contractual Service Margin – Illustration of unlocking

Period 1:
Favourable change
in estimated fulfilment cash flows (remaining duration four years)

Period 2:
Unfavourable change
in estimated fulfilment cash flows

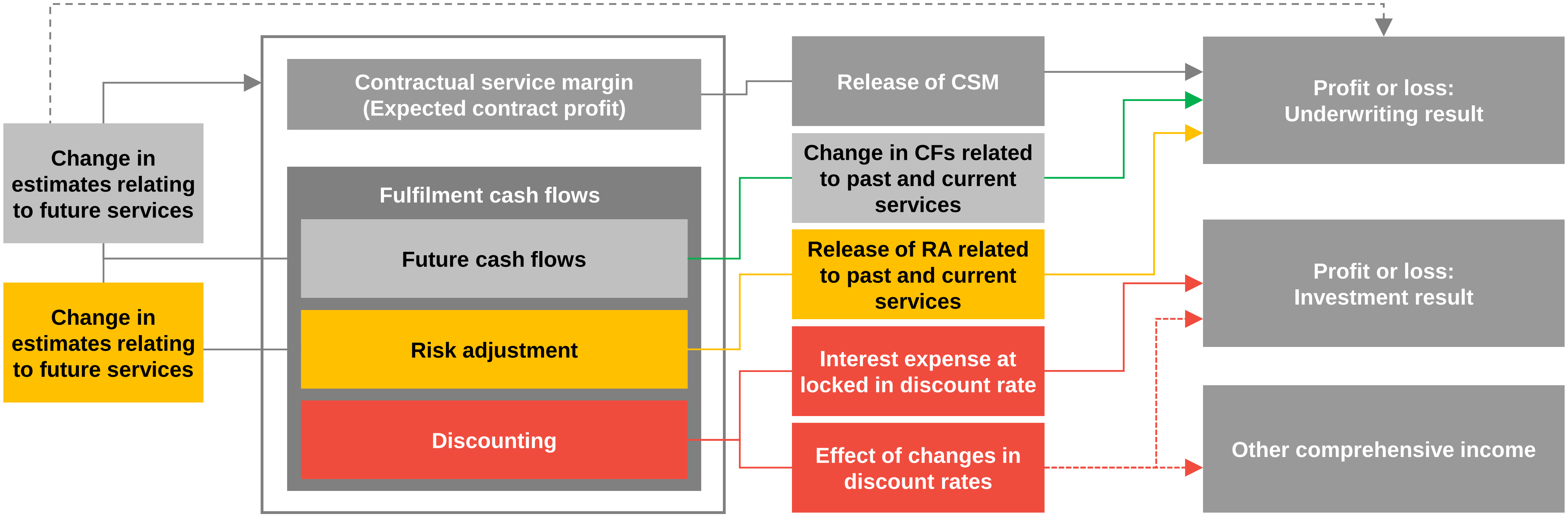
Period 3:
Unfavourable change in the estimated fulfilment cash flows exceeding CSM balance

Simplified example, no discounting applied

GM – subsequent measurement

Presentation of changes overview

The IASB proposed to disaggregate changes in the measurement of the insurance contracts in different line items of the financial statements, depending on the sources of the changes.



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Premium Allocation Approach

Insurance contract liability split into:

Liability for remaining coverage

simplified approach based on allocation of premium (analogous to existing UPR, net of DAC and premium receivables)

Liability for incurred claims

(analogous to existing unpaid claim reserves)

Like Unearned Premium Reserve – but net of DAC and premium receivables

Like best estimate claim reserves – but expected value, discounted and probability weighted with a risk adjustment

Premium Allocation Approach (cont'd)

- The PAA may be used if:
  - Contract coverage period is one year or less, or
  - PAA expected to produce measurement of the liability for the group that will not differ materially from one that would be produced by applying GM. This criterion is not met if significant variability of the fulfilment cash flows is expected (considering e.g., length of the coverage period and the presence of any embedded derivatives)
- Onerous contracts: additional (onerous contracts) liability (including risk adjustment) recorded
- Time value of money to be reflected if a significant financing component is included and coverage is provided more than 1 year after premium payment
- For revenue, expected premium receipts for the coverage period would be allocated based on the passage of time or the expected pattern of release from risk if the latter differs significantly from the passage of time.

Ceded Reinsurance – Summary of requirements

- Ceded reinsurance largely follows the approach for direct and assumed business although there are some key differences:
  - The decision on whether PAA is applicable needs to be considered separately for the ceded reinsurance
  - No gains or losses are made on inception (unless coverage is retroactive)
  - An allowance for expected credit losses is included within the cash flows
  - Ceding commissions – premium related accounted as premium, claim related accounted claims
  - Recognition date is the later of reinsurance contract group inception date and (if proportional reinsurance) date of recognition of underlying contract
  - The risk adjustment is based on the amount of risk transferred. i.e. difference between the gross and the net risk adjustments

Premium Allocation Approach

Questions for Discussion

- How to assess whether PAA is a reasonable approximation?
- How to apply the level of aggregation to the PAA?
- If available, when would the PAA model be beneficial?
- Use OCI option for incurred claims liabilities?
- How do you judge if the pattern of release from risk is significantly different from the passage of time?

Agenda

Statement of Comprehensive Income – A huge change from today

Illustrative

Statement of comprehensive income	
Insurance contracts revenue	X
Claims and expenses incurred	(X)
Underwriting result	X
Investment income	X
Interest expenses	(X)
Investment result	X
Other profit and loss	X
Corporate tax	(X)
Profit after tax	X
Other comprehensive income	(X)
Total comprehensive income	X

- Release in contractual service margin
- Change in risk adjustment
- Expected claims (in fulfilment cash flows)
- Expected expenses (in fulfilment cash flows)
- Allocating premium relating to the recovery of directly attributable acquisition costs
- **Excluding investment components**

- Actual claims incurred
- Actual expenses incurred
- Allocating premium relating to the recovery of directly attributable acquisition costs
- Onerous contracts
- **Excluding investment components**

- Calculated using locked-in rates (if the OCI option is selected)

- Effect of discount rate changes on BEL (if the OCI option is selected)

Disclosures – Purpose and type of information

In general

- **Purpose:**
  - Information concerning the **amount**, the **future development** and uncertainties of **cash flows** resulting from the insurance contracts
- **Qualitative and quantitative information concerning:**
  - Balance sheet and P/L items
  - Significant estimations and their changes
  - Type and extent of risks, including sensitivity analysis
- **Adequate aggregation level**
  - Contract type, product group
  - Geography
  - Reportable segment, as defined in IFRS 8
- **Transition** to income and expenses in P/L and to assets and liabilities in balance sheet in **tabular format**
- Information concerning **reinsurance assets**

Disclosures – Overview

Balance sheet and P/L items			
Development of B/S items during business year	Used valuation methods and inputs	Transition of booked premiums to insurance revenues	Interest curve for discounting

Type and extent of risks

In general	Insurance risks	Other risks
Risk appetite	Risk exposure	Risk exposure
Risk management	Risk concentrations	Risk concentrations
Regulatory law	Claims settlement	Maturity analysis
	Sensitivity analysis	Sensitivity analysis concerning market risks

Questions and Discussion